



April 15, 2011

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RE: CERT Comments on ARB's Proposed Penalty Policy

INTRODUCTION

The Californians for Enforcement Reform and Transparency ("CERT")¹ appreciate the opportunity to comment on CARB's proposed "Enforcement Penalties: Background and Policy" ("Penalty Policy") dated February 25, 2011. CERT is committed to working cooperatively with CARB and other stakeholders to achieve helpful reforms to strengthen and improve CARB's enforcement program. A formal penalty policy (where universal criteria are consistently applied across CARB's programs in every enforcement case) will benefit the ARB and air quality while achieving the "good government" goals in SB 1402.

At its core, the penalty policy should be a tool which the public, the regulated community, and CARB can use to ensure transparency, consistency, and fairness. The policy should provide a coherent, reliable framework to assess penalty amounts that distinguish between the seriousness of the air quality impacts, based on different categories of violations. The goal should be finalizing a policy where everyone can know, within a range, what penalty to expect from a certain type or category of violation. In turn, this will result in a more efficient and fair settlement process. With this goal, and these fundamental principles in mind, CERT appreciates this opportunity to provide comments and constructive suggestions on ARB's proposed Penalty Policy.

¹ CERT members include: American Home Furnishing Alliance (AHFA); California Chapter of the American Fence Contractors Association; California Dump Truck Owner Association (CDTOA); California Motorcycle Dealers Association (CMDA); California Moving and Storage Association (CMSA); California Retailers Association (CRA); Construction Industry Air Quality Association (CIAQC) – and several of their affiliates; Engineering Contractors Association; Flasher/Barricade Association; Independent Waste Oil Collectors and Transporters; Marine Builders Association; Moving and Storage Association; National Marine Manufacturers Association (NMMA); Outdoor Power Equipment Institute (OPEI); Compliant Car Builders Association; Southern California Contractors Association.

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Unfortunately, it would be impossible for the public—or any company facing a civil penalty connected with a mobile source violation—to review the proposed policy and understand how CARB assesses a penalty in a fair and consistent manner pursuant to SB 1402.

The Penalty Policy, as proposed, mostly summarizes the prior status quo (pre-SB 1402). It similarly fails to provide a meaningful explanation of how CARB intends to integrate and apply SB 1402’s new criteria to generate consistent and transparent penalties for the same or similar violations. To comply with SB 1402, the penalty policy must incorporate several fundamental components, including:

(1) A clear description regarding the scope of applicability, including specific statutory provisions and CARB programs affected. For example, CERT understands that CARB considers SB 1402 to apply to the heavy-duty diesel program, but it is unclear from the written policy whether it does (*see* also discussion below in section I.A). Such ambiguity generates uncertainty for the regulated community and the public and is the type of confusion SB 1402 sought to resolve.

(2) A clear explanation of the process for calculating a penalty under the eight specified criteria, including how CARB will distinguish between air and non-air quality violations; how (or if) CARB will consider or calculate the economic benefit and the air quality and gravity components of a violation; what adjustment factors apply to a penalty calculation and specific, transparent information for how CARB will apply those factors; further adjustment factors such as history of compliance, repeat violator status, and cooperation of defendant; and a detailed explanation of how each of these factors will be used to calculate an aggregate penalty.

I. The Current Statutory Enforcement Scheme - Quantification of “Excess Emissions” Above an Air Quality Standard

A. SB 1402

SB 1402, which the California legislature adopted unanimously, changed how penalties are to be assessed. SB 1402 specifically requires an enforcement scheme where penalties are consistent and consistently reflect the magnitude of the harm to California’s air quality. Specifically, SB 1402 now requires CARB to use its authority to distinguish enforcement cases and penalties primarily based on air quality impacts (*i.e.*, excess emissions). Section 43024 of SB 1402 directs CARB to develop a comprehensive penalty policy that must take into account eight criteria. The first two of those criteria—“the extent of harm to public health” and “the magnitude of the excess emissions” caused by the violations—are intentionally premised on CARB assessing excess emissions (if any). In fact, SB 1402 directs CARB to achieve this purpose through two interrelated provisions. Sections 39619.7 (which required CARB notifications to alleged violations starting on September 28, 2010) and Section 43024 (which required CARB to develop a

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penalty policy by March 1, 2011) are intended to work in tandem with the same goals—that is, the penalty policy should devise a transparent process/methodology for quantifying “excess emissions above an applicable standard” for certain violations (*i.e.*, § 43024), and then this process/methodology should be applied, where applicable, as part of the § 39619.7 notification requirement. Under the penalty policy required by § 43024, CARB must consider the extent of harm to the public and the “magnitude of *excess* emissions.” The term the “magnitude of excess emissions” in §43024 was meant to refer back to the term “excess” emissions above a specified pollution level—as used in § 39619.7. Specifically, § 39619.7 requires CARB to provide written notification to each violator that provides “the quantification of the specific amount of pollution emitted” in “*excess* of a provision of law that prohibits the emission of pollution at a *specified level*.” The legislature carefully chose language and designed a scheme to distinguish air quality violations with “excess emissions” above “specified levels” from labeling or other minor administrative violations, which do not exceed or violate a specified emission limit.

At CARB’s March 29th workshop on its penalty policy, the California Chamber of Commerce, the California Manufacturers and Technology Association (CMTA), and CERT similarly urged CARB to use its delegated authority to distinguish between minor regulatory and statutory violations that are procedural or administrative only (*e.g.*, recordkeeping, reporting, labeling violations) that do result in “excess” emissions above an applicable air quality standard – from serious air quality violations that result in “excess emissions above an applicable standard.”

At the March 29th workshop (and in its proposed penalty policy), CARB disagreed with these stakeholders and claimed that it is not required to (and does not intend to) distinguish between violations that may result in excess emissions above an applicable standard—and those violations that do not have such excess emissions. At this workshop (and in its penalty policy as discussed below), CARB’s incorrect interpretation was essentially that “all violations (including the most minor administrative violations) result in illegal emissions and all such emissions are excess – even if they do not exceed an applicable emission standard or cause damage to air quality.”

Moreover, in recent settlements, CARB enforcement staff has taken the unlawful position that SB 1402 removes enforcement discretion and requires maximum penalties. In advancing this position, and in its subsequent actions, CARB is directly contradicting the spirit and intent SB 1402. Since SB 1402’s enactment, virtually all mobile source enforcements have been for violations of the Periodic Smoke Inspection Program (PSIP). Yet, remarkably, CARB has failed to comply with core provisions of SB 1402 in these settlements (particularly in failing to calculate excess emissions). It is, therefore, impossible to determine whether these violations involved excess emissions, and if so the level of those excesses, whether they were

recordkeeping/administrative only, and the relevant aggravating or mitigating factors for the penalty.

In short, CARB's failure to comply with important notification provisions of SB 1402 for these PSIP violations is destroying the fundamental purpose of SB 1402, which is to make the enforcement process more transparent, consistent, and fair. CARB's position that SB 1402 strips enforcement officials of discretion and requires maximum penalties flouts a "good government" law that unanimously passed the California legislature, and runs roughshod over fundamental principles of due process, checks and balances, and separation of powers.

II. Distinguishing Grades of Violations that Cause Excess Emissions from Violations that do not Cause Excess Emissions

A. Legal Considerations

SB 1402 makes it clear that CARB must quantify and consider "excess emissions above an applicable standard." CARB should characterize only emissions above this standard as "excess." However, the ARB's proposed penalty policy states: "*In cases involving vehicles, engines, pieces of equipment, fuels or products not certified to ARB's air quality standards, the emissions from these illegal units are illegal and excess as well.*" See *Proposed Enforcement Penalties: Background and Policy* at 21.

CARB's flawed position is inconsistent not only with the clear language in SB 1402—but also with CARB's long-standing practices in implementing other related statutory penalty criteria. SB 1402 is modeled and based on the same statutory penalty criteria under the fuels program (§ 43024) which requires a nearly identical process. To comply with the same requirements to consider the "magnitude of excess emissions" (as used under § 43024), section 43029 requires that penalties for fuels violations be calculated based on "the number of tons of incremental increased vehicular emissions resulting from the manufacture, distribution, and sale... of noncompliant fuel" times a specified amount per ton. See HSC §§ 43029(a) and (b). CARB is also required to review and update as necessary "the methodologies used to calculate the excess emissions from noncompliant fuels." See HSC § 43029(c)(2).

Throughout the draft penalty policy, CARB appears to rely on *The People v. Wilmshurst*, (1999) 68 Cal. App.4th 1332, to support the notion that all illegal emissions are excess. See *Proposed Penalty Policy*, at item #23. At issue in that case was whether ARB had the authority to issue a civil penalty for the violation of certification requirements despite an ostensible lack of excess emissions. In holding that ARB had such statutory authority, the court deferred to the statutory scheme, noting that the legislature has "eschewed" an enforcement scheme that requires

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CARB to prove the amount of emissions stemming from a particular vehicle in every case. *See* opinion at 1351.

ARB's position needs to be updated to accurately account for the new applicable statutory scheme after the unanimous adoption of SB 1402. Since the events underlying *Wilmshurst*, the legislature has spoken both in the fuels program (§ 43031) and most recently in SB 1402, both of which require that ARB's enforcement scheme distinguish excess emissions above an applicable standard from administrative violations or non-emissions causing violations. Proper deference to this changed legislative scheme requires penalty amounts to be greater for those violations that harm air quality via excess emissions (whether they be associated with certification violations under Health and Safety Code §§ 43151-43153, or emissions violations under § 43211).

B. EPA Penalty Policy

To address the same type of "excess emissions" criteria as those in SB 1402, the U.S. EPA developed a comprehensive Mobile Source Penalty Policy to efficiently evaluate and distinguish between air quality impacts from different types or categories of violations. EPA has effectively applied this penalty policy matrix to dozens of violations over the last two years. Attached as Exhibit A is a summary of this Policy prepared by George Lawrence (who was the Chief of the EPA Mobile Source Enforcement branch that developed this policy). The two most influential criteria EPA applies in violations is "the gravity of the violation" and "the economic benefit of avoided compliance costs." (See EPA Penalty Policy attached as Exhibit B). EPA's "gravity component" is primarily defined by "the actual or potential harm" to air quality—which under the EPA policy "focuses on whether, and to what extent, *excess emissions result from the violations.*" (See enclosed Penalty Policy at p.12).

To adequately estimate the actual or potential excess emissions resulting from a violation, EPA considers "engine size, emission control devices that are missing or defective, and the effectiveness of actions taken to remedy or mitigate the violation." (See EPA Penalty Policy at p.12). As part of this evaluation, EPA applies the following categories. First, "*major*" violations "applies to violations where excess emissions are likely to occur. For example, engines with a missing or defective catalytic converter." EPA also designates as a "major" engine violation when test data "shows the engine to exceed emission standards." (See Penalty Policy at p. 13).

EPA applies a "lesser egregiousness category, *moderate*... to violations involving an uncertified vehicle or engine where the emissions from the vehicles or engines are likely to be similar to emissions from certified vehicles or engines." For example, EPA notes:

A company may have obtained an emissions certificate from EPA for a particular engine family, but these engines were produced, introduced into commerce, or imported before the

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date the certificate was issued. Engines produced before the certificate was issued would be uncertified, but the company may be able to show the subject engines are identical to engines produced after the certificate was issued.

As another example of “*moderate*” violations, EPA noted a case where “the emissions label is missing altogether.”

EPA applies a third category, “*minor*,” to “vehicles or engines with emission control labels that are defective, but the certification status of the engine nevertheless can be determined from the label.” (See Exhibit B at p.14). As an example of this type of minor violation, EPA cites to “an emissions label that is attached to the vehicle or engine in a manner that it can be removed without being destroyed or defaced.”

The EPA Penalty Policy provides specific illustrations of how the “major,” “moderate,” and “minor” classifications are applied through “adjustment multipliers” in hypothetical cases to account for (and distinguish between) the different levels of “excess emissions.” (See Exhibit B at p. 16-22).

Finally, EPA also has developed a special policy to address “carry over” engine families in a manner that recognizes there would be no excess emissions or avoided economic benefits – due to the fact such families have already been certified to the same standards and are therefore emission-compliant. (See Exhibit A at p.5).

C. CERT Recommendations

CERT would like to work with CARB on a policy that clearly and consistently recognizes the minor administrative violations that do not result in any “exceedence” of an “applicable emission standard.” CERT recommends that ARB identify in the Penalty Policy the types of procedural or administrative violations which would not result or produce any “excess emissions” above an applicable standard—such as— (i) recordkeeping and reporting violations; (ii) labeling and test procedure violations; and (iii) violations of administrative requirements involving products with emissions in compliance with or below applicable standards.

It is unclear from the proposed Penalty Policy when and how CARB plans to ever quantify “excess emissions” in order to distinguish between major and minor violations. CARB states in the penalty policy: “[s]ince acquiring the data necessary to quantify these illegal emissions (when it exists at all) can be time consuming and expensive, ARB makes these calculations where practicable in accordance with SB 1402.” (See page 21). Based on the constructive solutions in SB-724, CARB should create an opportunity in the final penalty policy for the regulated entity to provide creditable emission (or other) data to inform CARB’s quantification of “excess emission.”

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To practically achieve the requirements in SB 1402, CERT suggests the following approach, which does not require CARB to test any products. This approach is set forth in the enclosed CERT correspondence to CARB dated March 29, 2011.

For any violation the manufacturer should be allowed (and provided notice by CARB that it has the opportunity) to submit to CARB its documented quantification of any emission exceedences so that CARB can be better informed and so that it can comply with SB 1402 (and related clarifying amendments in proposed SB 724). Indeed, under its averaging-credits program, CARB already relies on manufacturers to quantify emissions from the annual production of each emissions family for purposes of generating and banking emissions credits. The methodology proposed by CERT to quantify emissions and related exceedences would be similar to the averaging methodology, allowing the manufacturer to provide an emissions quantification (using per unit emissions data and other factors [such as horsepower] already established by CARB under its ABT program). CARB may solicit additional information as needed.

Where the emission exceedence is non-existent or not significant, (such as with labeling violations) SB 1402's enforcement scheme requires that the violator receive a lower penalty over similar violations where it is impossible to quantify or likely that there has been emissions exceedences. (See EPA classification discussed above).

Where a violation has likely resulted in substantial emission exceedences, and/or the manufacturer is either unwilling or unable to provide test data or other information regarding potential exceedences, SB 1402's enforcement scheme requires that the penalty policy levy the greatest penalties. High risk products that have never been certified by either EPA or CARB in any model year would typically fall into this category.

This type of logical, tiered approach has several advantages. First, it focuses on air quality (as mandated by SB 1402), and allows CARB to implement a progressive penalty structure that most severely penalizes (and deters) those violations that cause the most harm to California's air quality. Second, it places the burden on the manufacturer, not CARB, to demonstrate that the violation does or does not result in emissions exceedences. Third, it essentially uses emissions exceedences as a proxy for avoided compliance costs as in almost every case where emissions exceedences are greatest, avoided compliance costs will be substantial. Therefore, without requiring CARB to back-calculate avoided compliance costs, the penalty policy will nonetheless account for this factor, which will, in turn, level the competitive playing field and ensure that the cleanest, newest, and greenest products reach the market. Finally, this approach would help CARB reach settlements more efficiently (and avoid litigation) because the regulated community could transparently know they were being treated fairly and consistently.

III. Penalty Criteria Based on “Compliance History of the Defendant”

In the final penalty policy, it would be helpful for ARB to elaborate on how it implements the criteria in section 43024 of SB 1402 in terms of evaluating the “compliance history of the defendant.” CARB’s proposed policy refers to concerns about deterring “repeat violations,” but does not define that term. In its final policy, CARB should make clear its process for how it factors in “repeat violations” when determining penalties. CARB should define what it means by a “repeat violation,” including the parameters for what constitutes a “repeat violation” (*e.g.*, same type of violation, same type of product, sunset period etc.). CARB should also include, as part of its written communication under § 39619.7, whether any penalty assessed involves a “repeat violation” and how that factored into the ultimate penalty.

IV. Explanation of How Per Unit Penalty is Calculated

Section 39619.7 of SB 1402 states that the ARB must provide a written explanation to the violator of the manner in which the administrative or civil penalty was determined on a per-unit basis (where applicable). Section 39619.7 also requires the ARB to explain the provision of law or regulations under which the penalty is being addressed, including the reason that provision is most appropriate for that violation. CERT encourages ARB to explain in its final penalty policy the process or methodology it consistently applies to develop a per-unit penalty assessment. (For example, under the EPA penalty policy, the Agency calculates (on a per unit basis) the air quality or gravity components, and the economic benefit components, and then makes adjustments based on specific criteria.) Indeed, a more robust explanation is required to serve the transparency and good government goals of SB 1402.

As part of this discussion in its penalty policy, ARB should specifically address the three categorical issues – as CERT requested in its prior comment to ARB submitted in October 2010.

A. Selection of HSC Provisions.

As part of the final penalty policy, ARB should explain how it selects and how it distinguishes between multiple overlapping (competing) provisions of the Health and Safety Code (*e.g.*, HSC sections 43016, 43154, 43211 and 43212, which vary from \$50/vehicle to \$5,000/vehicle, and vary from certification violations to emission standards violations; *see also* CERT October 2009 and 2010 comments regarding these confusing sections). CARB should clarify under what circumstances CARB chooses to seek penalties under these overlapping H&S Code provisions.

The direction under these statutes is vague (*e.g.* §43154 may be used against manufacturers/dealers for certification violations, while §43212 may be used against

manufacturers/dealer for emissions standards or test procedure violations, but the penalty amount differs by an order of magnitude of 100).

Often times CARB uses both §43212 and §43154 for the same product/violation. It is similarly unclear why and when CARB uses §43212 for “labeling” violations, since §43212 says nothing about labeling. Similarly, CARB most frequently uses § 43154, which authorizes penalties for certification violations, for emission standards violations, yet § 43211 provides clear and direct authority for emission standards violations. CARB should explain this. Section 43016, which authorizes CARB to seek penalties of \$500 per vehicle for general violations of the Vehicle Air Pollution regulations, seems to be a catch-all provision. However, there is no apparent consistency for when CARB uses §43016 vs. §43154 vs. §43212. CARB should clarify under what circumstances it chooses to seek penalties under these overlapping H&S Code provisions.

B. Duplicative Penalties for the Same Violation

CARB should avoid duplicative penalties, but when intending to do so, make clear how and when it assesses multiple penalties against the same entity for the same conduct (*e.g.*, if and how CARB assesses multiple penalties for non-certification against the same entity for the same uncertified product under, for example, H&S § 43151 and 43153, or if and how CARB assesses multiple penalties for importing, distributing, and selling a non-certified product under H&S § 43152). The penalty policy should explain how and when CARB assesses penalties that total more than the statutory maximum on a per vehicle basis.²

C. Carryovers

A large majority of CARB’s mobile source certification applications are for the certification of carry-over products (*i.e.*, those products that have been certified in the prior model year, and for which neither the product nor the applicable CARB standards have changed for the current model year). Given that legitimate carry-over products are emissions-compliant, a penalty policy provision that addresses carry-over products will save CARB resources and expedite the certification of a large number of products. Because violations associated with carry-over certifications are almost always administrative in nature, EPA typically applies a generic penalty of \$10,000 per affected engine family because a per unit/vehicle penalty would be significantly excessive where these violations do not cause “excess emissions.” As part of its penalty policy, CARB (like EPA) should develop a consistent policy that considers the real emission impact for minor administrative violations associated with carry-over certifications.

² The most often used statutory authorities (sections 43106, and 43154) contain statutory maximum penalty amounts, and authorize CARB to assess penalties not to exceed that amount per vehicle. Section 43212 contains a \$50 per vehicle authorization without the “not to exceed” language.

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V. Administrative Hearing Process

CERT urges CARB to take the opportunity during formulation of the SB 1402 penalty policy, to clarify and consider expanding its administrative appeals process. In the outreach documents, CARB states “[a]dministrative hearings are available for some of ARB’s cases, but as in its other cases, ARB decides whether to refer cases for administrative hearings.” See “Plain Language Overview” at 2. CARB admits that the Health and Safety Code “does not provide criteria for determining when a case should be referred to administrative hearing.” *Id.* In the name of transparency, the penalty policy should.

It is unclear why CARB has chosen to make administrative hearing processes available for only a limited subset of possible mobile source violations. It is CERT’s understanding that, with respect to mobile source violations, the only available administrative hearing process made available by CARB is for citations issued under CARB’s heavy-duty vehicle inspection program. See Cal. Code of Regs. Tit. 17 §§ 60075.1-60075.45. Yet, existing regulations provide administrative hearing procedures and authority for administrative hearings for a wide variety of CARB’s mobile source activities, including violations associated with certification. See Tit. 17 §60055.1.

For all the reasons that were raised by numerous stakeholders at last October’s workshop, CERT would like to discuss with CARB making an administrative hearing process available across more mobile source programs, including for mobile source and equipment certification violations, and off-road diesel violations. CERT generally agrees with CARB that the majority of enforcement proceedings can usually be settled. However, for those where legitimate disputes exist, the regulated community and CARB should have available an efficient forum in which to be heard apart from a court of law. This would help both CARB and the regulated community conserve resources by avoiding costly litigation.

* * *

CERT and its members look forward to working with you on these suggested recommendations to achieve our mutual goals. Thanks for your consideration.

John Dunlap
Bill Guerry

cc: Senator Dutton
Senator Correa

Exhibit A

Note on the U.S. Environmental Protection Agency's Penalty Policy for Violations Arising Under the Vehicle and Engine Emissions Certification Requirements under the Clean Air Act¹

On January 16, 2009, the U.S. Environmental Protection Agency (EPA) issued the Penalty Policy for violations of the Clean Air Act (CAA) Vehicle and Engine Certification Requirements (Penalty Policy).² This Penalty Policy was developed in response to a significant increase in the number and types of vehicle/engine enforcement actions being prosecuted by EPA. This increase occurred because many categories of nonroad vehicles and engines first became subject to emission standards during the period 1998 through 2006, including recreational vehicles, non-road gasoline and diesel engines, marine engines, and locomotives. In addition, there was a significant increase in prosecutions involving importations of uncertified vehicles/engines from China.

The Penalty Policy was developed to calculate penalty amounts in vehicle/engine enforcement actions in an easy and objective manner. Under the Policy, penalties usually can be calculated using information contained in inspection reports, which avoids the time and expense of gathering additional technical information prior to beginning an

¹ The author of this note is George Lawrence, who worked for almost thirty years as an attorney at the U. S. Environmental Protection Agency in the Mobile Source Enforcement office. During his career at EPA, Mr. Lawrence represented or supervised attorneys who represented the Agency in hundreds of enforcement cases involving violations of the motor vehicle and motor vehicle fuels requirements under the Clean Air Act, including violations of the vehicle and engine emissions certification requirements, the tampering prohibition and the gasoline and diesel fuel regulations. From 1998 through 2007 Mr. Lawrence was the Chief of the Mobile Source Enforcement Branch, the office responsible for nationwide enforcement of all violations of EPA's motor vehicle and fuels requirements, and for developing the enforcement provisions of new vehicle/engine and motor vehicle fuels regulations. During 2007 and 2008, Mr. Lawrence developed and authored the Penalty Policy for violations of the Vehicle and Engine Certification Requirements. Mr. Lawrence retired from EPA in August 2008.

² See, <http://cfpub.epa.gov/compliance/resources/policies/civil/penalty>.

enforcement action. In addition, penalty amounts calculated under the Policy reflect the comparative egregiousness of violations across the entire vehicle/engine practice area, so that enforcement consistency is achieved.

Penalties calculated under the Policy are based on the factors specified in the Clean Air Act for setting penalties for violations of the vehicle and engine certification requirements.³ Therefore, under the Policy the economic benefit and gravity penalty components are calculated and combined to yield the preliminary penalty amount. This preliminary penalty is adjusted to address the remainder of the statutory factors to calculate the final penalty amount.

The economic benefit penalty component is intended to recover any significant economic benefit of noncompliance to the violator. However, precise calculation of a violator's economic benefit normally would require a fact-specific economic analysis that is time-consuming and expensive. As a result, the Penalty Policy uses a "rule of thumb" method of calculating economic benefit based on the number of vehicles or engines in violation and their horsepower.⁴

³ Under Section 205(a) of the CAA, the maximum penalty for violations of the vehicle and engine requirements is \$25,000 (later increased to \$32,500) per vehicle or engine, with two exceptions. The maximum penalty for violations of the tampering prohibition when committed by any person other than a manufacturer is \$2,500 (later increased to \$2,750) per vehicle, and the maximum penalty for violations of the defeat device prohibition is \$2,500 (later increased to \$2,750) per device.

Sections 205(b) and (c)(2) of the CAA specify that penalties for specific violations of the vehicle and engine certification requirements should be based on: the gravity of the violation; the economic benefit or savings resulting from the violation; the size of the violator's business; the violator's history of compliance; action taken to remedy the violation; the effect of the penalty on the violator's ability to continue in business; and other matters as justice may require.

⁴ The "rule of thumb" approach is appropriate for calculating economic benefit because the violator's economic benefit in most vehicle/engine cases involves the failure to meet some or all of the certification requirements. Moreover, the cost of emissions control is roughly proportional to engine horsepower. The

The gravity penalty component is calculated under the Penalty Policy to reflect the egregiousness of the violation based on the potential for excess emissions or degree of program harm. The factors that result in greater potential for excess emissions are: larger engine horsepower; larger number of vehicles or engines; whether the particular violation is likely to result in actual excess emissions (e.g., a missing catalytic converter is more egregious than missing label information); and whether the violator has remedied the violation.⁵

The Penalty Policy has proven to be an effective tool for standardizing and streamlining the enforcement practice for most types of violations involving all categories of highway and non-road vehicles and engines. The Policy standardizes the mobile source enforcement practice by providing an objective method of measuring the potential and actual environmental harm for most vehicle/engine violations. The Policy streamlines the enforcement practice by basing the economic benefit and gravity penalty calculations on readily-available information, such as engine horsepower and number of vehicles/engines in violation. This allows most routine enforcement cases to proceed without the need for emissions testing or other in-depth technical evaluation of the vehicles/engines in violation.

horsepower and number of the vehicles/engines in violation normally is known, so the rule of thumb estimate can be calculated without having to conduct a case-specific economic analysis. Nevertheless, evidence of actual economic benefit can be substituted in any particular case if the violator has evidence the rule of thumb estimate is too high or if the government has evidence this estimate is too low.

⁵ The Penalty Policy includes scaling factors for the number of engines/vehicles in violation and the horsepower, so that penalty amounts are appropriate when the number of engines/vehicles in violation and/or their horsepower is small or large.

Violations Involving Failure to Properly Obtain a Carry-Over Certificate

EPA has treated certain violations that resulted from a failure to properly obtain a carry-over certificate as an exception to the penalty calculation approach described above. This exception applied only in the following limited situation: the company had properly obtained a certificate for the engine family at issue for the prior year; there was no change in emission standards for that engine family from the prior year to the year at issue, so that obtaining a carry-over certificate would have been pro-forma; the company continued to manufacture vehicles/engines in that engine family identical to those manufactured during the prior year, so these vehicles/engines would have been fully compliant had the company properly obtained a carry-over certificate; the company subsequently obtained a proper carry-over certificate for the engine family; the company obtained no other regulatory advantage, such as through average-banking-trading (ABT); and the company had no prior violations of this nature. This exception was not included in the Penalty Policy, but was used by EPA enforcement staff in cases where these conditions were present.⁶

In this limited situation, EPA charged a penalty of \$10,000 per engine family for which a proper carry-over certificate was not obtained, instead of a penalty based on the number of vehicles/engines in the engine family and their engine size. Thus, for example, if a company failed to properly obtain certificates for five engine families and

⁶ This discussion of the penalty calculation approach used by EPA for certain cases involving carry-over certificates is based on the experience of the author of this note before August 2008. In his experience, this carry-over certificate exception was applied consistently in about five cases that met the conditions discussed above.

each engine family met the conditions described above, EPA would seek a penalty of \$50,000. EPA would not adjust a penalty calculated under this exception, up or down, based on normal adjustment factors, such as business size or cooperation. In addition, EPA would not engage in negotiations with the company to reduce such a penalty.

The rationale for this carry-over certificate exception is that penalties calculated in the normal manner in these cases often would be very large, particularly if the engine family at issue has a large number of vehicles/engines or large horsepower engines. For example, the penalty for 5,000 uncertified cars where no excess emissions occur would be almost \$1 million. In addition, in the situation where the carry-over certificate exception applies the company has obtained no economic benefit. Rather, the company has invested to obtain a proper certificate (in the prior year) and to produce vehicles/engines that comply with that certificate. Carry-over certificate violations typically are caused by administrative mistake or oversight. The harm in such a case is to program integrity rather than from excess emissions, and this harm is essentially the same regardless of the number of vehicles/engines implicated or their horsepower.

The carry-over certificate exception also is appropriate because, by virtue of the lower penalty amount, it allows these cases to be processed quickly through the informal administrative settlement agreement approach, discussed below. The penalty in such a case, if calculated using the normal Penalty Policy approach, probably would be much larger, which would make resolution of the case more difficult, time-consuming and expensive. Moreover, if the penalty calculated for a case is larger than \$270,000 EPA is

required to refer the case to the Department of Justice for district court filing,⁷ with even greater resource implications for the government.

Forum of Mobile Source Enforcement Practice

EPA enforces almost all mobile source cases with a penalty amount less than the DOJ referral cap of \$270,000 by negotiating settlement terms with the violator that are memorialized in informal administrative settlement agreements (ASA).⁸ In these informal agreements the violator typically agrees to pay a penalty and to undertake remedial actions. If the violator complies with the terms of the ASA, EPA agrees to treat the matter as resolved and to forego initiation of a formal enforcement action. If the violator does not comply with the terms of the ASA, EPA reserves the right to seek administrative or judicial enforcement based on the violation or to enforce the terms of the ASA.

⁷ Under Section 205(c)(1) of the CAA, EPA is required to refer a case to the Department of Justice for prosecution in district court if the penalty amount is over \$200,000, unless EPA and DOJ agree to waive this penalty cap in a particular case. The amount of this penalty cap has been increased to \$270,000. This penalty cap analysis is based on the penalty calculated by EPA for the case and not the statutory maximum penalty for the violations.

⁸ Authority for EPA to enter into informal settlement agreements is based on language contained in Section 205(c)(1) of the CAA. This section, which provides authority for EPA to assess civil penalties, also states that “[t]he Administrator may compromise, or remit, with or without conditions, any administrative penalty which may be imposed under this section.” This language has been interpreted as authority for EPA to negotiate informal settlements that include both civil penalties and injunctive relief.

Exhibit B



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

JAN 16 2009

MEMORANDUM

OFFICE OF
ENFORCEMENT AND
COMPLIANCE ASSURANCE

SUBJECT: Clean Air Act Mobile Source Civil Penalty Policy – Vehicle and Engine Certification Requirements

FROM: Granta Y. Nakayama
Assistant Administrator

A handwritten signature in black ink, appearing to read "Granta Y. Nakayama".

TO: Mobile Source Enforcement Personnel

Attached is the final Civil Penalty Policy – Vehicle and Engine Certification Requirements under the Clean Air Act. This policy is intended to be used by EPA in calculating the penalty that the Agency will seek in settlement of civil judicial and administrative enforcement actions for violations of the Vehicle and Engine requirements under Title II of the Act. It will be provided to the public through publication in the Federal Register.

This policy establishes a framework EPA expects to use in exercising its enforcement discretion in determining an appropriate settlement amount for such cases. It is immediately effective, and supersedes the following policies: Tampering and Defeat Device Civil Penalty Policy for Notices of Violations (Feb. 28, 1994); Manufacturers Programs Branch Interim Penalty Policy (Mar. 31, 1993). The policy applies to all civil and administrative actions initiated after this date, and all pending actions in which the government has not yet transmitted a proposed settlement penalty amount. It may be applied in pending cases in which penalty negotiations have commenced, at the discretion of the litigation team.

If you have any questions about this policy, please contact Jacqueline Robles Werner (202-564-1036) in the Air Enforcement Division of the Office of Civil Enforcement.

Attachment

Clean Air Act

Mobile Source Civil Penalty Policy

**Title II of the Clean Air Act
Vehicle and Engine Emissions Certification Requirements**

U.S. EPA

January 2009

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I. Introduction and Applicability

This document sets forth the policy of the U.S. Environmental Protection Agency (EPA) for assessing civil penalties for violations of certain Clean Air Act provisions concerning motor vehicles and motor vehicle engines, and non-road engines and equipment ("Penalty Policy" or "Policy"). This Penalty Policy adheres to the EPA *Policy on Civil Penalties* (EPA General Enforcement Policy #GM-21, February 16, 1984, recodified as PT.1-1), and *A Framework for Statute-Specific Approaches to Penalty Assessments* (EPA General Enforcement Policy #GM-22, February 16, 1984, recodified as PT.1-2) (collectively referred to in this Penalty Policy as the *Policy on Civil Penalties*). Accordingly, the purposes of this Policy are to deter potential violators, to ensure that EPA assesses fair and equitable civil penalties, and to expedite the resolution of claims arising from certain categories of non-compliance with the Act.

This Penalty Policy applies to violations of Title II of the Clean Air Act (Act) -- Emission Standards for Moving Sources, 42 U.S.C. §§ 7521 - 7590, and regulations promulgated thereunder, that apply to vehicles and engines.¹ These provisions require that vehicles and engines be certified by EPA to meet emissions standards that are specific to each category and size of vehicle or engine. They also include requirements for record-keeping, emissions labeling, reporting of emission control defects, and warranties of vehicle/engine emission-related components. The Title II provisions also prohibit tampering with, or installing devices to defeat, the emissions controls of a vehicle or engine.

Thus, this Policy applies to violations such as the following:

- The manufacture and sale, or the importation, of uncertified vehicles or engines in violation of Section 203(a)(1) of the Act, 42 U.S.C. § 7522(a)(1);
- The manufacture and sale, or the importation, of vehicles or engines without an appropriate emissions label, in violation of Section 203(a)(4)(A) of the Act, 42 U.S.C. § 7522(a)(4)(A);

¹ The regulations pertaining to motor vehicles and engines include the following:

Highway vehicles and engines	40 C.F.R. Part 86
Non-road diesel engines	40 C.F.R. Parts 89 and 1039
Small non-road gasoline engines	40 C.F.R. Part 90
Large non-road gasoline engines	40 C.F.R. Part 1048
Marine gasoline engines	40 C.F.R. Part 91
Marine diesel engines	40 C.F.R. Part 94 and 1039
Locomotives	40 C.F.R. Part 92
Recreational vehicles and engines	40 C.F.R. Part 1051
General requirements	40 C.F.R. Part 1068

- The manufacture and sale, or the importation, of vehicles or engines without an appropriate emissions warranty, in violation of Section 203(a)(4)(D) of the Act, 42 U.S.C. § 7522(a)(4)(D);
- Violations of the emission control tampering prohibition under Section 203(a)(3)(A) of the Act, 42 U.S.C. § 7522(a)(3)(A); and
- Violations of the emission control defeat device prohibition under Section 203(a)(3)(B) of the Act, 42 U.S.C. § 7522(a)(3)(B).

Under Section 205(a) of the Act, 42 U.S.C. § 7524(a), the maximum penalty for violations of the vehicle and engine requirements under Title II of the Act is \$25,000 per vehicle or engine, with two exceptions. The maximum penalty for violations of the tampering prohibition when committed by any person other than a manufacturer is \$2,500 per vehicle, and the maximum penalty for violations of the defeat device prohibition is \$2,500 per device. These maximum penalty amounts were increased from \$25,000 to \$32,500 and from \$2,500 to \$2,750 for violations occurring after March 15, 2004, through January 12, 2009, and to \$37,500 and \$3,750 for violations occurring thereafter (*see* Civil Monetary Penalty Inflation Adjustment Rule, 69 Fed. Reg. 7121 (Feb. 13, 2004) and Civil Monetary Penalty Inflation Adjustment Rule, 73 Fed. Reg. 75340 (Dec. 11, 2008)).

Section 205(b) of the Act, 42 U.S.C. § 7524(b) provides the factors that a court should take into account when determining the amount of any penalty in a judicial action under Title II of the Act:

In determining the amount of any civil penalty to be assessed [in a civil judicial action] the court shall take into account the gravity of the violation, the economic benefit or savings (if any) resulting from the violation, the size of the violator's business, the violator's history of compliance with [Title II of the Act], action taken to remedy the violation, the effect of the penalty on the violator's ability to continue in business, and such other matters as justice may require.

Section 205(c)(2) specifies that these same factors should be taken into account in an administrative penalty assessment for violation of requirements under Title II of the Act.

Section 205(c)(1) of the Act specifies that, in lieu of referring a case to the Department of Justice to commence a civil action in district court, EPA may enforce the violation through an administrative penalty assessment, provided the penalty amount is less than \$200,000, unless EPA and the Department of Justice agree that a matter with a larger penalty is appropriate for administrative penalty assessment. This penalty cap on administrative actions was increased to \$295,000 under the 2008 Civil Monetary Penalty Inflation Adjustment Rule.

EPA's administrative enforcement of Title II of the Act may result in settlement terms with the violator that are memorialized in informal administrative settlement agreements (ASA), in lieu of commencing a formal administrative action to assess civil penalties or filing a complaint in federal district court. In these informal agreements the violator typically agrees to pay a penalty and to undertake specific remedial actions. If the violator complies with the terms of the ASA, EPA agrees to treat the matter as resolved and to forego initiation of a formal enforcement action. An ASA also specifies that if the violator does not comply with the terms of the ASA, EPA reserves the right to seek enforcement based on the violation or to enforce the terms of the ASA. In addition, EPA reserves the right to enforce violations of the requirements of Title II of the Act through the formal EPA administrative process under 40 C.F.R. Part 22, or through referral to the Department of Justice for filing in federal district court.

Accordingly, this Penalty Policy should be used to calculate settlement amounts for cases that are settled through administrative settlement agreements. This Policy also should be used to calculate the appropriate penalty to assess under the Consolidated Rules of 40 C.F.R. Part 22. However, this Policy is not intended to and does not control the penalty amount requested in judicial actions. It is EPA's policy, in judicial actions, to assert a claim for up to the maximum penalty allowable under the Act. Therefore, after a case has been referred to the Department of Justice, use of this Policy is limited to agreements reached with defendants through negotiated settlements.

The procedures set forth in this document are intended solely for the guidance of government personnel. They are not intended and cannot be relied upon to create rights, substantive or procedural, enforceable by any party in litigation with the United States. The Agency reserves the right to act at variance with this Policy and to change it at any time without public notice. This Penalty Policy is effective immediately with respect to all cases in which the first penalty offer has not yet been transmitted to the opposing party.

This Penalty Policy first describes how to calculate the "economic benefit penalty component" and the "gravity penalty component," which, when added together, results in the "preliminary deterrence amount." The Policy then discusses adjustment factors that are applied to the gravity-based component of the penalty or to the preliminary deterrence amount to arrive at an "initial penalty target figure," which is the penalty amount used at the beginning of negotiations with a violator. Finally, the Policy describes the process for any further adjustments to the initial penalty target figure during negotiations with the violator, which results in the penalty amount that is appropriate for resolving the case, called the "adjusted penalty target figure."

II. The Preliminary Deterrence Amount

The *Policy on Civil Penalties* establishes deterrence as an important goal of penalty assessment. More specifically, the *Policy on Civil Penalties* provides that any penalty should, at a minimum, remove any significant economic benefit resulting from noncompliance. In addition, it should include an amount beyond recovery of the economic benefit to reflect the seriousness of the violation. That portion of the penalty which recovers the economic benefit of

noncompliance is referred to as the “economic benefit component;” that part of the penalty which reflects the seriousness of the violation is referred to as the “gravity component.” When combined, these two components yield the “preliminary deterrence amount.”

This section provides guidelines for calculating both the economic benefit component and the gravity component.

A. The Economic Benefit Component

To ensure that penalties obtained in settlement recover any significant economic benefit of noncompliance,² it is necessary to have reliable economic benefit calculation methods. This section sets out guidelines for computing the economic benefit component. It addresses three categories of economic benefit: delayed costs; avoided costs; and the benefit from competitive advantage gained as a result of the violation. This third type of benefit is referred to as “beyond BEN benefit” or “BBB.” This section also describes a “rule of thumb” method for calculating the economic benefit resulting from certain types of violations of the mobile source vehicle and engine requirements. The “rule of thumb” described in this Policy should be used by the case team to estimate the economic benefit of noncompliance only when information regarding the actual cost of noncompliance is not available.

1. *Benefit from Delayed Costs*

In many instances, the economic advantage to be derived from noncompliance is the ability to delay making the expenditures necessary to achieve compliance. Delayed costs fall into two categories: capital expenses and one-time non-depreciable costs necessary to achieve compliance with the relevant environmental requirement. Capital expenses are simply things that wear out and need replacement.³ One time non-depreciable expenses do not involve things that wear out and are thus nonrecurring.⁴ A company would achieve an economic benefit by deferring either of these costs until it either decides on its own to comply or until EPA takes an enforcement action.

² The “economic benefit of noncompliance” is sometimes referred to as “BEN.”

³ The distinction between these categories of delayed costs is appropriate because of the different tax treatment they receive and as a consequence, the potential benefit gained by the violator.

⁴ In addition, if a one-time outlay is a tax deductible business expense, then the tax benefit from that expense is enjoyed in the year the company makes that expenditure. In contrast, a firm with the depreciable expenditure gets to deduct only a portion of that piece of equipment’s cost every year for the applicable depreciation period. In the rare case where they are not deductible (*e.g.*, the purchase of land to site a waste water pretreatment plant) the firm does not enjoy any tax benefit.

Examples of violations that may result in savings from deferred capital expenses are the following:

- Failure to install production-line equipment, or to implement production-line process changes, to ensure that vehicles or engines are manufactured to meet emission standards; or
- Failure to install required monitoring or testing equipment at a factory producing vehicles or engines to ensure that the vehicles or engines will meet emission standards.

Examples of violations that may result in savings from deferred one-time non-depreciable expenses are the following:

- Delayed installation of appropriate emission controls in engines being distributed in commerce;
- Failure to conduct a one-time test in a timely manner; and
- Delay in obtaining certification that an engine meets applicable regulatory standards.

In some circumstances, noncompliance with mobile source vehicle or engine requirements may not result in an economic benefit to the violator from delayed costs. However, to the extent economic benefits from delayed costs are present in mobile source vehicle or engine cases, these costs should be computed using EPA's BEN model.⁵

⁵ EPA has five models for dealing with civil penalty issues:

- BEN – Calculates a violator's economic benefit from delayed or avoided costs;
- ABEL – Evaluates a corporation's or partnership's ability to afford penalties and compliance costs;
- PROJECT – Calculates the actual cost of supplemental environmental projects to violators;
- INDIPAY – Evaluates an individual's ability to afford penalties and compliance costs; and
- MUNIPAY – Evaluates a municipality's ability to afford penalties and compliance costs.

Information about these models is available at: www.epa.gov/compliance/civil/econmodels/index.html.

2. *Benefit from Avoided Costs*

Many types of violations enable a violator to avoid certain costs associated with compliance. Examples of benefits from avoided costs in mobile source vehicle or engine cases include the following:⁶

- Failure to conduct the testing and submit the information necessary to obtain an emissions certificate of conformity for vehicles or engines introduced into commerce or imported by the violator;
- Failure to install pollution control devices on vehicles or engines, which normally result in uncertified vehicles or engines;⁷ and
- Importing uncertified, instead of certified, vehicles or engines into the United States.

As discussed below, for settlement purposes a “rule of thumb” approach may be appropriate for calculating the benefit from violations resulting from introducing into commerce or importing uncertified vehicles or engines. When the rule of thumb approach is not appropriate, the economic benefit of avoided costs should be computed using the BEN methodology. However, there are instances where neither the rule of thumb nor the BEN methodology are appropriate for calculating the actual economic benefit of noncompliance. In those instances, the litigation team should develop and use a case-specific method of calculating economic benefit,

⁶ The normal avoided costs BEN addresses are costs that occur annually such as electricity, labor, materials, and insurance premiums. However, most avoided costs in the mobile source program fall into the category of one-time, non-depreciable expenditures that are avoided, not delayed, which requires a specific setting in the BEN model. Those unfamiliar with the BEN model and how to apply it in these situations are urged to contact the Agency’s Financial Issues Helpline at (888) 326-6778.

⁷ For purposes of this Penalty Policy, a vehicle or engine is considered to be “uncertified” if, for any reason, it is not completely compliant with an EPA emissions certificate of conformity. Vehicles or engines would therefore be considered uncertified in the following circumstances:

- A certificate of conformity for the vehicles or engines was not sought or obtained by the manufacturer or importer; or
- A certificate of conformity was obtained for certain vehicles or engines, but the vehicles or engines were not manufactured in the manner specified in the certificate. For example, a vehicle or engine manufactured without an emission control part specified in the manufacturer’s certificate application would be uncertified.

which should be described in the case documents. In developing such an alternative approach, the litigation team is strongly advised to consult with the previously mentioned Financial Issues Helpline at (888) 326-6778.

3. *Beyond BEN Benefit*

A third category of benefit, which is not the result of avoided or delayed costs, reflects the benefits to the violator from business transactions that would not have occurred but for the illegal conduct, and/or the competitive advantage the violator obtained in the marketplace as compared to companies that have complied with the motor vehicle emission control laws and regulations. This benefit category is called “beyond BEN benefit” or “BBB.”⁸ Mobile source cases where BBB may be present are characterized by vehicles or engines that are attractive to consumers primarily because they offer performance or features not possible with legal vehicles or engines, or because they can be sold at prices not possible with legal vehicles or engines. Similarly, illegal defeat devices and emission control tampering may be attractive to consumers primarily because they result in engine performance not possible with legal engine parts or modifications. Examples of violations that may include BBB are:

- Introducing into commerce or importing uncertified vehicles or engines where the engines have been sold and no recall of the engines is possible;
- Sale of emission control defeat devices; and
- Removing or altering pollution control equipment for a fee (*e.g.*, tampering with mobile source emission control devices).

To adequately remove the economic incentive for violations that include BBB, normally it is appropriate to base the economic benefit penalty component on the net profits made from the improper transactions, *i.e.*, the amount the violator’s profits from the sale of uncertified vehicle(s) or engine(s) exceeded the amounts that would have resulted if the party had sold certified vehicle(s) or engine(s), the profits from the sale of illegal device(s), or the profits from tampering.⁹

The BEN methodology is not designed to calculate the economic benefit resulting from BBB. Where this category of benefit is present, the litigation team should use a case-specific method of calculating the economic benefit, which should be described in the case documents.

⁸ BBB was formerly referred to as “illegal competitive advantage” or ICA.

⁹ While the net profit would be the normal measure of economic benefit in these situations, the Agency reserves the right to treat the gross proceeds from the sale of the noncompliant product or the total fee charged for tampering as the measure of economic benefit in appropriate cases, or any other measure that is appropriate to the situation.

For assistance in developing a case-specific method, contact the Financial Issues Helpline at (888) 326-6778.

4. *Rule of Thumb Estimate of Economic Benefit*

The economic benefits that result from the sale of uncertified vehicles or engines may have elements of both avoided costs and benefit from BBB. In cases where illegal vehicles or engines are imported but not introduced into commerce, or are introduced into commerce but are recalled, there will only be BEN-type benefit. Consider, for example, a violator that introduces into commerce a piece of equipment containing an engine without a catalytic converter when a catalyst is necessary to meet emission standards. The violator may have avoided the cost of installing the catalytic converter when the engine was manufactured. In the case of imported engines, the importer may have purchased a less expensive engine that was manufactured without a catalyst, thereby avoiding the cost of purchasing a more expensive, fully-compliant engine, for import into the United States. The violator also may have gained a BBB in the marketplace by introducing into commerce or importing an engine that cost less to produce or purchase. Under either analysis, the cost of purchasing and installing the catalytic converter may be used to approximate the violator's economic benefit from the introduction into commerce or importation of the uncertified engine.

In its enforcement of Title II of the Act, EPA has developed a substantial amount of experience in calculating the economic benefit that results from introducing into commerce or importing uncertified vehicles or engines. This experience indicates that it is possible to estimate the benefit through the use of simple formulas. This will be referred to as the "rule of thumb" method in this Penalty Policy.

In particular, the rule of thumb calculates economic benefit in proportion to engine size, which is adjusted to reflect the cost of actions the violator takes to remediate uncertified vehicles or engines. Note that the rule of thumb calculation is generally appropriate for missing emission controls and similar types of violations. While the litigation team may use the rule of thumb model for other types of vehicle and engine violations (*e.g.*, warranty violations), the team should be aware that the model may not represent the best fit for these types of violations, and should attempt to verify the economic benefit estimate.

a. *Rule of Thumb Benefit Calculation*

Engines regulated under Title II of the Act range in size from very small (*e.g.*, a one horsepower string trimmer) to very large (*e.g.*, marine diesel engines can be 100,000 horsepower or larger), and the cost increment to manufacture a certified engine versus an engine without emission controls is roughly proportional to the engine's size. This is true regardless of the engine type (gasoline or diesel). For purposes of this Policy, the following "rule of thumb" for economic benefit may be used:

- Engines that power cars and light-duty trucks are relatively similar in size (engines in cars range from about 1 to 8 liters), and as a result, for purposes of this rule of

thumb economic benefit for all cars and light-duty trucks is calculated based on an engine size of 250 horsepower.¹⁰

- The cost of emission controls is also roughly proportional to the engine size, and is estimated to be about \$1 per horsepower. As a result, the rule of thumb for calculating the per-engine economic benefit from introducing into commerce or importing an uncertified nonroad engine, recreational vehicle or a heavy-duty highway vehicle is \$1 per horsepower.
- For very small engines (*e.g.*, engines under about 15 horsepower), the cost of manufacturing a certified engine is more than \$1 per horsepower. As a result, the estimated “rule of thumb” economic benefit should be no smaller than \$15 per engine, regardless of the engine’s size. If the engine violation at issue is solely a missing or defective emission control label, the “rule of thumb” economic benefit is \$5 per engine.

Consider, for example, a hypothetical company, Vehicle/Engine Imports, Inc., that imported five fork lifts powered by uncertified gasoline engines that are 125 horsepower in size, and the engines are uncertified because catalytic converters, required by the applicable emissions certificate of conformity, were not installed. Using the “rule of thumb,” the estimated economic benefit to Vehicle/Engine Imports, Inc., for one engine would be $125 \times \$1 = \125 , and the total unadjusted economic benefit for all five engines would be $5 \times \$125 = \625 .

b. Rule of Thumb Adjustment to Reflect Remedial Actions

This Penalty Policy is intended to provide incentives for companies to remedy violations involving uncertified vehicles or engines in order to prevent the actual excess emissions that would result from their use. This remedial action normally takes the form of exporting the uncertified vehicles or engines out of the United States, recalling and repairing them, or, under certain limited circumstances, installing proper emissions labels. In such situations, the cost to the violator of completing these remedial actions can be larger than the economic benefit to the violator from introducing into commerce or importing the uncertified vehicles or engines.

As a result, in the case of vehicles or engines that are the subject of appropriate remediation, the rule of thumb estimate of economic benefit may be reduced or eliminated for these vehicles or engines as part of a settlement that fully remediates the violation. Thus, if a violator remediates some, but not all, of the uncertified vehicles or engines at issue in a case, the economic benefit penalty component should be calculated based on the number of vehicles or

¹⁰ The actual horsepower of highway and off-highway motorcycles should be used, and not the 250 horsepower assumption.

engines for which remedial actions are not completed.¹¹ Remedial actions may be considered completed if they occur before a final administrative or civil judicial settlement of the case is negotiated, or if the remedial actions are a requirement of the settlement agreement.

However, if the litigation team believes that the cost of remedial actions does not offset the violator's economic benefit in this manner in any particular case, the reduction in the economic benefit component of the penalty to reflect remediation should be modified accordingly. The basis for any such modification should be described in the case documents.

To illustrate this adjustment to the economic benefit, consider once again the example of Vehicle/Engine Imports, Inc., that imported five fork lifts with uncertified engines with an estimated economic benefit was \$125 per fork lift. Assume that three of these fork lifts were sold into United States commerce and were not the subject of remediation, but that the importer exported 2 of these fork lifts before they left the port of entry. As a result, the adjusted economic benefit should be calculated based on the three fork lifts that were not the subject of remediation, or $3 \times \$125 = \375 .

c. Situations Where Use of "Rule of Thumb" is Inappropriate

The rule of thumb method only provides a "first-cut estimate" of the economic benefit of avoided compliance. For this reason, use of the rule of thumb method is typically inappropriate for use in situations where a detailed analysis of the economic benefit of noncompliance is needed to support or defend the Agency's position. Accordingly, the rule of thumb method generally should not be used in any of the following circumstances:

- The case team is not confident that the case will settle (or the defendant has not indicated a desire to settle the alleged violations);
- A hearing is likely on the amount of the penalty;
- The defendant identifies economic benefit factors that are unique to the case; or
- The case development team has reason to believe it will produce a substantially inaccurate estimate.

¹¹ Remediation of violations is relevant to the gravity of violations as well as to economic benefit. As discussed more fully in the gravity portion of this Penalty Policy, uncertified vehicles or engines that are allowed to operate in the United States can result in significant adverse environmental impacts. As a result, the gravity penalty component is larger where the vehicles or engines are not corrected through recall or other appropriate remediation.

5. *Economic Benefit for Violations Other than Uncertified Vehicles or Engines*

The rule of thumb estimate of economic benefit is also intended to apply primarily to cases where uncertified vehicles or engines are introduced into commerce or imported (*i.e.*, where economic benefit is delayed, and/or compliance expenditures are avoided). This rule of thumb may not be appropriate for other types of mobile source violations. For example, cases involving tampering with emission controls or the sale of emission control defeat devices do not fit within the rule of thumb. The rule of thumb also is inappropriate for violations such as failure to report emission control defects or failure to honor emission control warranties.

As a result, in a case involving violations that are not based on uncertified vehicles or engines, the litigation team should develop a method for calculating the economic benefit using the general considerations of delayed cost, avoided cost and benefit from BBB, discussed above. In this circumstance, the method used to calculate economic benefit should be described in the case documents.

B. *The Gravity Component*

As noted above, the *Policy on Civil Penalties* specifies that for a penalty to achieve deterrence it should, in addition to recovering any economic benefit of noncompliance, recover an additional amount to reflect the seriousness of the violation. Similarly, Sections 205(b) and (c)(2) of the Act specify that penalties for violations of Title II of the Act should take into account the gravity of the violations. This section of the Penalty Policy establishes a method that quantifies the gravity component of the penalty.

The specific objective factors in this Penalty Policy are designed to measure the seriousness of the violation and reflect the considerations described in the *Policy on Civil Penalties*:

- Actual or potential harm. This factor focuses on whether (and to what extent) the activity of the violator actually resulted in, or was likely to result in, the emission of a pollutant in violation of the standards specified for the particular vehicles or engines at issue.
- Importance to the regulatory scheme. This factor focuses on the importance of the requirement to achieving the goals of the Clean Air Act and its implementing regulations.¹²

¹² For example, the mobile source regulations require that vehicles and engines subject to emissions certification standards must be permanently labeled, and that the labels contain certain required emissions and other information. If a manufacturer or importer fails to properly label vehicles or engines, it becomes more difficult for inspectors to determine compliance of this equipment with the emissions certification requirements at the time of import. In addition,

Assigning a dollar figure to represent the gravity of the violations, at its core, involves the consideration of a variety of factors and circumstances. However, linking the dollar amount of the gravity component to objective factors is a useful way of ensuring that violations of approximately equal seriousness are treated similarly.

1. *Actual or Potential Harm*

In the case of violations of the mobile source requirements for vehicles and engines, the actual or potential harm focuses on whether, and to what extent, excess emissions result from the violations. Excess emissions are a function of at least two considerations, and possibly others depending on the facts of the case: (1) the number of violative engines or vehicles; and (2) the amount of excess emissions that will be emitted from each uncertified vehicle or engine over the vehicle's or engine's useful life.

The first consideration can be quantified in a straightforward and objective manner. The number of uncertified vehicles or engines that were imported or introduced into commerce normally is known or is readily ascertainable (*e.g.*, through company records).

However, the second consideration – the amount of excess emissions attributable to the violation(s) – may not be known with certainty, because precise quantification would require emissions testing of the uncertified engines which is time-consuming, resource-intensive, and may not be possible if the subject engines are not in EPA's or the violator's possession. Nevertheless, the potential for excess emissions normally can be estimated in an objective manner based on the following considerations: engine size; emission control devices that are missing or defective; and the effectiveness of actions taken to remedy or mitigate the violation.

- a. *Engine Size*

Similar to the discussion of the economic benefit "rule of thumb" for nonroad engines, recreational vehicles and heavy-duty highway vehicles, above, the amount of emissions from such engines or vehicles is proportional to the engine's size. Thus, the potential for *excess* emissions from a nonroad engine, recreational vehicle or heavy-duty highway vehicle also is proportional to the engine's size. In addition, the size of engines that are the focus of enforcement actions normally is known from commercial documents or importation records. As a result, the gravity penalty component under this Penalty Policy for violations involving uncertified vehicles and engines is calculated to be proportional to the engine size. In the case of automobiles and light-duty trucks, gravity is calculated based upon the assumed engine size of 250 horsepower, as discussed above.

consumers who may wish to purchase the equipment cannot easily identify certified vehicles or engines if the emissions label is inadequate or missing.

b. Egregiousness

Under this Penalty Policy, the egregiousness of a violation refers to the likelihood that the emissions from the vehicles or engines in violation may exceed certified levels or applicable standards. The most egregiousness category of violations, "Major," applies to violations where excess emissions are likely to occur. For example, engines with missing or defective catalytic converters would be expected to have emissions that are greater than those on which proper catalytic converters had been installed. Most other emission control devices, if missing or defective, also would be expected to result in increased emissions. Also, violations should be classified as "Major" if vehicles or engines are uncertified and there is no information about the emissions from these vehicles or engines, or test data of the uncertified engines shows the engines to exceed emissions standards (however, see the discussion below for violations involving emissions labels).

A lesser egregiousness category, "Moderate," applies to violations involving uncertified vehicles or engines where the emissions from the vehicles or engines are likely to be similar to emissions from certified vehicles or engines. For example, a company may have obtained an emissions certificate from EPA for a particular engine family, but these engines were produced, introduced into commerce, or imported before the date the certificate was issued. Engines produced before the certificate was issued would be uncertified, but the company may be able to show the subject engines are identical to engines produced after the certificate was issued. In this example, the violation would be classified as "Moderate."

Another example of a "Moderate" level of egregiousness would involve vehicles or engines that are properly covered by a certificate of conformity, but the emissions label is missing altogether or the content of the emissions label is sufficiently deficient that the certification status of the vehicle/engine cannot be determined. For example, an emissions label violation should be classified as "Moderate" if information identifying the engine family is missing from the label.

The litigation team should use available information about the vehicles or engines at issue to determine whether a violation should be classified as Major or Moderate. Normally, if there is uncertainty about the proper egregiousness classification, a violation should be classified as Major. The egregiousness category of any particular violation can later be changed, either to a greater or lesser egregiousness category, based on new information. For example, it would be appropriate to reclassify the egregiousness of a violation, from Major to Moderate level, if the violator is able to demonstrate during settlement discussions or in litigation that the vehicles or engines at issue have emissions do not exceed the certification emissions levels under the applicable certificate. However, litigation teams should evaluate the probative value and utility of emissions testing conducted subsequent to initiation of an enforcement action. Such testing, because it may be time-consuming, normally would not be consistent with the swift resolution of an enforcement action. As a result, for purposes of settlement, it may be appropriate to limit the evidence a violator can use to demonstrate the emissions of vehicles or engines to that which is in existence at the time that the violation was committed. An example of a case where this type of preexisting evidence is appropriate is where uncertified imported engines that are initially classified as Major egregiousness because the emissions are unknown. Where the importer

obtains information from the engine manufacturer demonstrating the imported engines are identical to engines manufactured under an EPA emissions certificate, the violation may be reclassified as Moderate. Litigation teams retain the discretion to consider emissions testing conducted in the course of the negotiations where, taking into account relevant facts and circumstances, such information assists in determining the extent of the violation.

A third egregiousness category, "Minor," involves vehicles or engines with emission control labels that are defective, but the certification status of the engine nevertheless can be determined from the label. An example of this type of violation is an emissions label that is attached to the vehicle or engine in a manner that it can be removed without being destroyed or defaced. A vehicle or engine with an emissions label that is defective in this way could have emissions that meet applicable standards. Alternatively, engines or vehicles that are labeled as legal for sale in the United States, but that in fact do not meet applicable emissions and other standards, should be considered a more egregious violation (Moderate or Major, depending on the facts of the particular case).

c. Effectiveness of Actions to Remedy or Mitigate the Violation

In general, penalties should be smaller for violators that take effective steps to promptly remedy any violation upon discovery of the noncompliance. In the context of violations of the vehicle and engine requirements, the resulting excess emissions often depend on whether, and how long, the vehicles or engines are used in the United States. Consider, for example, vehicles that are presented for importation into the United States, but are exported by the importer after the vehicles are identified as being uncertified at the time of importation. In this example, the importer would have violated the prohibition against importing uncertified vehicles when the uncertified vehicles were presented for importation. However, there would be no excess emission in the United States, because the uncertified vehicles are never used in the United States. Thus, in this example, there was the potential for excess emissions but no actual excess emissions occurred because the violative engines were exported. Contrast this example to a case in which uncertified vehicles are introduced into United States commerce and are operated for the vehicles' useful life, resulting in years of actual excess emissions.

Remedial action for uncertified vehicles or engines can occur through several means: they can be exported outside the United States; they can be destroyed; or they can be recalled and repaired.

Therefore, under this Penalty Policy, the gravity penalty component is smaller for uncertified vehicles and engines if appropriate, effective remedial actions are taken promptly. The litigation team has discretion to specify the percentage, up to 30 percent, by which the gravity is increased where remedial action is not taken. A 30 percent increase is used in the case of vehicles or engines for which no remedial action is taken, or where the action is ineffective. Percentages between zero and 30 percent are appropriate where some but not complete remedial actions are taken or where the remedial action was delayed.

2. *Importance to the Regulatory Scheme*

Even in the absence of harm in the form of excess emissions, the gravity component of the penalty should reflect the seriousness of the violation in terms of its effect on the regulatory program. For example, emission control labels are used by EPA and U.S. Customs and Border Protection (CBP) inspectors to identify whether engines or vehicles are certified and legal for sale and distribution in the United States. Noncompliance with the emissions labeling requirements compromises the ability of these inspectors to effectively exclude illegal, uncertified engines from the United States. Accordingly, the importance of the requirement to the regulatory scheme should always be taken into account in determining the egregiousness of the violation.

3. *Scaling Factors*

Violations for which penalties are calculated under this Penalty Policy can involve a very large range in terms of number of engines and in terms of engine sizes. For example, a case may involve a single instance in which one or two uncertified light-duty automobiles are imported, or may involve hundreds of thousands of uncertified cars introduced into commerce by a domestic manufacturer over a longer period of time. Similarly, nonroad engine violations can involve engines that range in size from 1 horsepower to over 100,000 horsepower. If a per-horsepower or per-engine gravity amount is used that results in penalties of an appropriate size for cases involving a small number and/or small size engines, this same per-horsepower or per-engine gravity amount may result in penalties that are inappropriately or unreasonably large, beyond what could reasonably be obtained in court, in cases where the number of uncertified engines and/or engine size is very large. As a result, this Penalty Policy includes scaling factors for both numbers of vehicles or engines, and for engine size in the case of nonroad engines. This scaling results in gravity penalty components that are appropriate for cases that involve a small number of engines and/or small horsepower engines, and for cases that involve a large number of engines and/or large horsepower engines.

4. *Business Size*

Under the *Policy on Civil Penalties*, the first goal of penalty assessment is deterrence. The size of the violator's business is relevant to determining whether the penalty will have a sufficient deterrent effect, and is one of the considerations that Section 205(b) of the Act specifies should be taken into account when calculating a civil penalty.

The amount of the gravity penalty component calculated under this Penalty Policy is intended to be sufficiently large to create an appropriate deterrent for violations committed by small companies. For larger companies, however, a larger penalty is necessary to create an appropriate deterrent. The specific scaling factors for the size of business is set forth in Table 4, below.

5. *Calculating the Gravity Component of a Penalty*

This Penalty Policy uses the gravity considerations and scaling factors described above to calculate gravity penalty components in the following manner.

- Calculate the base per-vehicle/engine gravity, scaled for engine horsepower;
- Adjust to reflect the egregiousness of the violation and the effect of remediation (if any);
- Apply scaling factors for the number of vehicles and/or engines; and
- Adjust to reflect the size of the business.

a. Calculate Base Per-Vehicle or Per-Engine Penalty

The first step is to calculate the base per-vehicle/engine penalty using Table 1 based on the engine size, in horsepower. In the case of automobiles and light-duty trucks, an engine size of 250 horsepower is used regardless of the actual size of the engines in the vehicles in violation.

In the case of violations of the emissions label requirements, the amount of the base per-vehicle/engine penalty is the amount calculated using Table 1 or \$500, whichever is smaller (*i.e.*, the base penalty for label violations is capped at \$500 per vehicle/engine).

HP	\$ / HP
1 - 10 HP	\$80
11 - 100 HP	\$20
101 - 1,000 HP	\$5
1,001 - 10,000 HP	\$1.25
10,000 + HP	\$0.31

Use of Table 1. Use Table 1 to calculate a base per-engine penalty by multiplying \$80 times the first 10 horsepower of the engine; \$20 times the next 90 horsepower; etc., and adding the results together. For example, consider again the example of Vehicle/Engine Imports, Inc., that imported five fork lifts powered by uncertified 125 horsepower engines that were missing the catalytic converter. The base per-engine gravity penalty for one of these engines would be: $\$80 \times 10 = \800 ; plus $\$20 \times 90 = \$1,800$; plus $\$5 \times 25 = \125 ; or a total of \$2,725.

b. Adjust the Gravity to Reflect Egregiousness

Adjust the per-vehicle/engine base gravity to reflect the egregiousness of the violation (as discussed above) using the adjustment factors from Table 2.

Egregiousness Category	Adjustment Multiplier
Major	6.5
Moderate	3.25
Minor	1

Use of Table 2. Multiply the per-vehicle/engine base gravity times the appropriate adjustment multiplier from Table 2. Consider once again the example of Vehicle/Engine Imports, Inc., that imported five fork lifts with uncertified 125 horsepower engines with missing catalytic converters, where the per-engine gravity was calculated to be \$2,725. Based on the discussion above, a missing catalytic converter would be expected to result in excess emissions. As a result, the egregiousness of these violations would be classified as Major. The per-engine gravity adjusted to reflect major egregiousness would be: $\$2,725 \times 6.5 = \$17,712.50$.

c. Calculate the Multiple Vehicle/Engine Gravity

Use Table 3 to scale the adjusted base per-vehicle/engine penalty to reflect the total number of vehicles or engines in violation.

Number of Vehicles/Engines	Scaling Factor
1 - 10	1
11 - 100	0.2
101 - 1,000	0.04
1,001 - 10,000	0.008
10,001 - 100,000	0.0016
100,001 +	0.00032

Use of Table 3. Multiply the adjusted base per-engine gravity times 1.0 for the first ten vehicles or engines, and add the adjusted base per-engine gravity times 0.2 for the next 90 vehicles or engines, etc. Consider again the example of Vehicle/Engine Imports, Inc., that imported five fork lifts with 125 horsepower uncertified engines, where the adjusted base per-engine gravity was \$17,712.50. The multiple engine gravity would be calculated as follows: $5 \times \$17,712.50 \times 1 = \$88,562.50$. The average per-engine gravity for this example is still \$17,712.50.

In cases involving vehicles or engines with multiple violations, the litigation team has the discretion to use the sum total of all violations for this penalty factor. For example, if the case involves two separate shipments, each with 30 noncompliant engines or vehicles with both label and warranty violations, the penalty could be calculated on the basis of a total of 120 violations.

The litigation team also has the discretion to “group” violations, and re-start the scaling factor in Table 3 for each group. For example, if the case involves five separate shipments, each with 30 noncompliant engines or vehicles, the penalty could be calculated on the basis of each transaction or occurrence giving rise to the violation (e.g., five separate violations of 30 engines each). Depending on the facts of the case, there may be other relevant criteria or bases on which to group the violations (e.g., by model, engine type, period of time, etc.).

d. Calculate the Multiple Vehicle/Engine Gravity For Each Vehicle/Engine Size and/or Egregiousness Categories

A case may include multiple categories of violations representing more than one size vehicle/engine and/or more than one egregiousness category. In this situation, the violation categories should be arranged with the violation category having the largest adjusted base per-vehicle/engine gravity first, and ending with the violation category with the smallest adjusted

base per-vehicle/engine gravity. These gravity amounts should then be scaled for the number of vehicles/engines in violation, using Table 3, in sequence.

For example, consider a case that has three different types of violations, each with a different adjusted per-vehicle/engine gravity amount:

Number of Vehicles/Engines	Adjusted Per-Vehicle/Engine Gravity
15	\$5,000
150	\$500
3	\$8,000

These violations should be arranged in the order of the adjusted base per-vehicle/engine gravity, starting with the largest, so the Table 3 scaling can be calculated in this sequence. This results in a total of ten vehicles/engines in the first Table 3 category, 90 vehicles/engines in the second category, and 68 vehicles in the third category.

Number of Vehicles/Engines	Adjusted Per-Vehicle/Engine Gravity	Number of Vehicles/Engines in Table 3 Category			
		1	2	3	4
3	\$8,000	3			
15	\$5,000	7	8		
150	\$500		82	68	

In this example, the multiple-vehicle gravity for the first violation category (three vehicles/engines; \$8,000 adjusted base per-vehicle/engine gravity) should be calculated as: $3 \times \$8,000 \times 1 = \$24,000$ (an average gravity of \$8,000 per vehicle/engine).

The multiple-vehicle gravity for the second violation category (15 vehicles/engines; \$5,000 adjusted base per-vehicle gravity) should be calculated as: $7 \times \$5,000 \times 1 = \$35,000$, plus $8 \times \$5,000 \times 0.2 = \$8,000$, or a total multiple-vehicle/engine gravity of \$43,000 (an average gravity of \$2,867 per vehicle/engine).

The multiple-vehicle gravity for the third violation category (150 vehicles/engines; \$500 adjusted base per-vehicle/engine gravity) should be calculated as: $82 \times \$500 \times 0.2 = \$8,200$, plus $68 \times \$500 \times 0.04 = \$1,360$, or a total multiple-vehicle/engine gravity of \$9,560 (an average gravity of \$64 per vehicle/engine).

The total multiple-vehicle gravity for all the violations in this example would be the sum of these multiple-vehicle penalties, or $\$24,000 + \$43,000 + \$9,560 = \$76,560$.

As noted in § II(B)(5)(c) above (“Calculate the Multiple Vehicle/Engine Gravity”), the litigation team has the discretion to “group” multiple vehicles or engines where appropriate. If vehicles or engines are “grouped,” the calculation for this factor should be consistent with that grouping.

e. Adjust the Gravity to Reflect Remediation

The next step is to increase the multiple vehicle/engine gravity to reflect the lack of remediation if the violations are not corrected through appropriate remedial actions. As discussed above, this adjustment requires the litigation team to specify the number of vehicles or engines that are the subject of remediation, and the percentage by which the penalty increases for vehicles or engines that are not the subject of remediation (up to 30 percent).

To make this adjustment, multiply the average per vehicle/engine gravity (calculated in the previous sections) times the number of vehicles/engines not remediated times the non-remediation percentage increase assigned by the litigation team. The result of this calculation should be added to the multiple-vehicle gravity, calculated in the previous section.

For example, consider once again the example of the five, 125 horsepower fork lifts imported by Vehicle/Engine Inc., with an average per-engine gravity of \$17,712.50. Assume that two of these engines were remediated by being exported, and that three were sold into commerce in the United States and, as a consequence, were not remediated. Assume further that the litigation team assigned a non-remediation increase of 30 percent. The incremental penalty amount to reflect non-remediation would be $3 \times \$17,712.50 \times 0.3 = \$15,941.25$.

The gravity penalty component adjusted for remediation would be: $\$88,562.50 + \$15,941.25 = \$104,503.75$.

f. Adjust the Gravity Penalty Component to Reflect Business Size

Increase the gravity penalty component to reflect the company’s size. This should typically be calculated on the basis of the company’s net worth (corporations) or net assets (partnerships or sole proprietorships). There may be instances where business size is more appropriately determined on some other basis (*e.g.*, gross revenues, number of employees, etc.). The basis on which the size of business is determined should be described in the case documents. The amount of these penalty increments are shown in Table 4.

Table 4. Incremental Gravity Penalty Component Amounts Based on Business Size	
Size of the Violator's Business	Incremental Gravity Penalty Component Amount
Under \$50,000	None
\$50,001 - \$100,000	\$5,000
\$100,001 - \$1,000,000	\$10,000
\$1,000,001 - \$5,000,000	\$20,000
\$5,000,001 - \$20,000,000	\$35,000
\$20,000,001 - \$40,000,000	\$50,000
\$40,000,001 - \$70,000,000	\$70,000
Above \$70,000,000	\$70,000 + \$25,000 for every additional \$30,000,000 or fraction thereof

In the case of a company with more than one facility or location, the size of the violator is determined based on the company's entire operation, and not solely the size of the facility or location at which the violation occurred. With regard to parent and subsidiary operations, only the violative entity should be considered, unless the case team determines that the parent company was involved with or directly oversaw the activities that gave rise to the violation. Where the size of violator component represents over 50% of the penalty component adjusted for remediation (from steps a. through e., above), the litigation team has discretion to reduce the size of violator figure. These thresholds may also be adjusted over time to account for inflation.

Use of Table 4. Once the case team has determined the business size of the violator, it should add the appropriate amount from Table 4 to the gravity penalty component adjusted for remediation. Consider, once again, the example of Vehicle/Engine Imports, Inc., that imported five fork lifts, where the gravity penalty component adjusted for remediation is \$104,503.75. Assume this company had a net worth of over \$13 million. Using Table 4, an additional \$35,000 would be added to the penalty. The final gravity penalty component would therefore be calculated by adding \$35,000 + \$104,503.75, or \$139,503.75.

g. Calculate the Gravity Penalty Component for Violations of the Tampering and Defeat Device Prohibitions

The gravity-calculation approach described above also is appropriate for calculating the gravity penalty component for violations of the tampering prohibition under Section 203(a)(3)(A) of the Act, and of the prohibition against manufacturing, offering for sale, selling or installing emission control defeat devices under Section 203 (a)(3)(B) of the Act.

In the case of tampering violations, the gravity penalty component should be calculated as if the vehicles or engines that were tampered with had been introduced into commerce or imported in the tampered condition. Thus, for example, if a repair shop removed the catalytic converters from a number of automobiles, the gravity would be based on engines of 250 horsepower in size, adjusted to reflect the number of vehicles tampered, egregiousness and remediation, and incremented to reflect business size.

In the case of violations of the defeat device prohibition, the gravity would be based on the vehicles or engines on which the defeat devices are installed or intended to be installed, and calculated as if these vehicles or engines had been introduced into commerce or imported with the defeat device installed. A separate penalty would be assessed for each defeat device manufactured, offered for sale, sold or installed.

h. Calculate the Gravity Penalty Component for Other Violations

The method of calculating the gravity penalty component described in this Penalty Policy is not to apply to cases that involve violations other than uncertified vehicles or engines, or violations of the tampering or defeat device prohibitions. These other types of violations include, for example, emission control defect reporting and emission control warranty violations.

As a result, in a case involving violations that are not based on uncertified vehicles or engines, or the tampering or defeat device prohibitions, the litigation team should develop a method for calculating the gravity penalty component using the general gravity penalty considerations discussed in this Penalty Policy and in the *Policy on Civil Penalties*. In this circumstance, the method used to calculate the gravity penalty component should be described in the case documents.

C. The Preliminary Deterrence Amount

As discussed above, under the *Policy on Civil Penalties* the preliminary deterrence amount is simply the sum of the economic benefit penalty component and the gravity penalty component. Under this Penalty Policy, the preliminary deterrence amount is the sum of the adjusted economic benefit and the fully adjusted gravity component, calculated as described above.

Continuing the example of Vehicle/Engine Importers, Inc., that imported five fork lifts powered by 125 horsepower uncertified engines with missing catalytic converters, the preliminary deterrence amount is the sum of the economic benefit penalty component (\$375) and the gravity

penalty component (\$139,503.75), or \$139,878.75. By comparison, if the same forklifts had been imported by a company with a net worth of \$75 million instead of Vehicle/Engine Importers, Inc.'s \$13 million, the preliminary deterrence amount would be \$199,878.75.

III. The Initial Penalty Target Figure

As discussed above, the *Policy on Civil Penalties* provides that the preliminary deterrence amount is simply the sum of the economic benefit penalty component and the gravity penalty component, each calculated as set forth above. In addition to deterrence, however, another goal of the *Policy on Civil Penalties* is the equitable treatment of the regulated community. This requires that penalty policies must have enough flexibility to account for the unique facts of each case and, at the same time, produce results that are consistent enough to treat similarly-situated violators similarly. This is accomplished by identifying many of the legitimate differences between cases and providing guidelines for how to adjust either the gravity component or the preliminary deterrence amount when those facts occur. The application of these adjustments prior to commencement of negotiation yields the initial penalty target figure. During the course of negotiations, the litigation team may further adjust this figure to yield the adjusted penalty target figure.

Consistent with the *Policy on Civil Penalties*, this section of the Penalty Policy discusses the application of adjustment factors to promote flexibility and to identify management techniques that will promote consistency. These factors are: degree of willfulness and/or negligence; degree of cooperation/non-cooperation; and the violator's history of noncompliance. In addition, the violator's ability to pay, litigation risk or other unique case-specific factors may also bear upon the final penalty. Other than a demonstrated inability to pay or litigation risk, these adjustment factors apply only to the gravity component and not to the economic benefit component. Violators bear the burden of justifying mitigation adjustments they propose based on these factors.

This Penalty Policy specifies the maximum percentage by which the penalty can be adjusted for each factor. The litigation team has discretion to select the adjustment percentage for each factor, within the specified ranges, based on the facts unique to each case, but the rationale for the amount of adjustment should be described in the case documents. Adjustments that are greater than the maximum percentages are possible in the case of unusual or extra-ordinary circumstances, but such larger adjustments must be approved by management of the Air Enforcement Division.

A. Degree of Willfulness and/or Negligence

Although the requirements of Title II of the Act and the implementing regulations are strict liability, this does not render the violator's willfulness and/or negligence irrelevant, and these considerations should be reflected in the gravity-based portion of the penalty.

In assessing the degree of willfulness and/or negligence, all of the following points should be considered in most cases:

- How much control the violator had over the events constituting the violation;
- The foreseeability of the events constituting the violation;
- Whether the violator took reasonable precautions against the events constituting the violation;
- Whether the violator knew or should have known of the possibility violations would occur;
- The level of sophistication within the industry in dealing with compliance issues and the availability of fully compliant vehicles or engines of the type at issue in the case being evaluated; and
- Whether the violator in fact knew of the legal requirement that was violated.

It should be noted that this last point, lack of knowledge of the legal requirement, should never be used as a basis to reduce the gravity-based portion of the penalty. To do so would encourage ignorance of the law. Rather, knowledge of the law should serve only to enhance penalty.

Under this Penalty Policy, the litigation team has discretion to increase or decrease the gravity-based portion of the penalty by up to 20 percent to reflect degree of willfulness and/or negligence. The basis for the level of this adjustment should be described in the case documents.

B. Degree of Cooperation/Non-Cooperation

The degree of cooperation or non-cooperation of the violator in resolving the violation is an appropriate factor to consider in adjusting the gravity-based portion of the penalty. Such adjustments are based on both the goals of equitable treatment and swift resolution of environmental problems.

A threshold indicator of cooperation or non-cooperation is whether the violator promptly reported its noncompliance to EPA. Cooperation can be manifested by the violator promptly reporting its noncompliance. In cases where the litigation team concludes the violator either knew or should have known about the violations, the team then has a basis for evaluating whether and how quickly the violator reported the violations to EPA. Assuming such self-reporting is not required by law or was otherwise not prompted by other governmental action (*i.e.*, the identification and disclosure of the violation was both voluntary and prompt), such behavior should result in the mitigation of the gravity-based portion of the penalty.

Consider, for example, a company that imports vehicles with emissions labels that state the vehicles are required to be equipped with catalytic converters, but catalytic converters are not installed on the vehicles. The importer could know these vehicles are not certified as soon as the importer had custody of the imported vehicles because of the discrepancy between the emissions

labels and the missing catalytic converters; the importer either knew or should have known about the violations at this point. In this example, the gravity-based portion of the penalty should be adjusted, either up or down, based upon how quickly the importer notified EPA of the imported uncertified vehicles after the importer first had custody of them.

There may be other indicia or facts indicating a violator's degree of cooperation other than prompt or delayed reporting of the violation. Under this Penalty Policy, the litigation team has discretion to increase or decrease the gravity-based portion of the penalty by up to 10 percent to reflect prompt reporting of the violation those actions or behavior bearing upon a violator's degree of cooperation. The basis for the level of this adjustment should be described in the case documents.

Note that voluntary actions taken to remedy the violation, such as initiating a recall of defective vehicles prior to conclusion of settlement discussions, are addressed as a separate factor in the initial gravity calculation (*see* § II(B)(2) "Prompt Correction of Violations," above), and should not be considered under this adjustment factor.

C. History of Noncompliance

The *Policy on Civil Penalties* provides that where a party has violated a similar environmental requirement before, this is usually clear evidence that the party was not deterred by the Agency's previous enforcement response. Unless the previous violation was caused by factors entirely out of the control of the violator, this is an indication that the gravity-based portion of the penalty should be adjusted upward.

In deciding how large these adjustments should be, the litigation team should consider the following points:

- How similar the previous violation was (more similar prior violations should result in a larger penalty increase);
- How recent the previous violation was (more recent prior violations should result in a larger penalty increase);
- The number of previous violations (more prior violations should result in a larger penalty increase); and
- The violator's efforts to remedy previous violations(s) (prior violations that were not corrected should result in a larger penalty increase).

A violation generally should be considered "similar" if the Agency's previous enforcement response should have alerted the party to a particular type of compliance problem. For purposes of this Penalty Policy, a "prior violation" includes any act or omission for which a formal enforcement response has occurred, *e.g.*, notice of violation, settlement agreement, warning letter, complaint, consent decree, consent agreement or final order. It also includes any act or omission

for which the violator has previously been given written notification, however informal, that the Agency believes a violation existed.

In the case of violations involving uncertified vehicles or engines, a “similar” violation is one that involves any violation of the vehicle and engine requirements under Title II of the Act or the regulations implementing those requirements.

In the case of a large corporation with many divisions or wholly-owned subsidiaries, it is sometimes difficult to determine whether a previous instance of noncompliance should trigger the adjustment for previous violations. In general, the litigation team should begin with the assumption that if the same parent corporation controlled both the corporate organization with the prior violation and the organization with the current violation, the adjustment for history of noncompliance should apply, unless the violator can demonstrate there was no corporate control or oversight linkage between the two organizations.

Under this Penalty Policy, the litigation team has discretion to increase the gravity-based portion of the penalty up to 35 percent for one prior violation, and up to 70 percent for more than one prior violation. The litigation team should evaluate the considerations discussed above, such as how similar the prior violation was and how long ago it occurred, when determining the percentage that is appropriate in any particular case. The basis for the level of this adjustment should be described in the case documents.

Use of Willfulness/Negligence, Cooperation and History of Noncompliance Factors. This example will again use Vehicle/Engine Importers, Inc.’s importation of five fork lifts with uncertified 125 horsepower engines, in which the gravity penalty component was \$139,503.75 and the economic benefit component was \$375. Assume the litigation team determined that the following adjustments are appropriate for this case:

- A 10% increase as an aggravating factor, to reflect the degree of the violator’s negligence;
- A 5% reduction as a mitigating factor, to reflect the violator’s prompt reporting of the violation to EPA and subsequent efforts to expeditiously resolve and address the violation; and
- A 10% increase as an aggravating factor, to reflect the violator’s prior history of noncompliance with other Title II requirements.

In this example, there is a net 15% increase of the gravity component of the penalty. Therefore, the \$139,503.75 gravity component is increased by \$20,925 ($0.15 \times \$139,503.75 = \$20,925$), for a total gravity penalty of \$160,428.75. The \$375 economic benefit is added to this amount for a total penalty of \$160,803.75.

IV. Ability to Pay

As described in the *Policy on Civil Penalties* and expanded upon in PT.2-1: Guidance on Determining a Violator's Ability to Pay a Civil Penalty (December 16, 1986) (Previously codified as GM 56), the Agency will generally not request penalties that are clearly beyond the means of the violator unless the violations are egregious or the violator refuses to comply on a timely basis. Therefore, under this Penalty Policy, the violator's ability to pay a penalty will be considered in arriving at a specific final penalty amount. At the same time, it is important that the regulated community not see a discount based on inability to pay as EPA sanctioning the efforts of a financially troubled company to gain an unfair competitive advantage by violating the vehicle and engine requirements.

Therefore, EPA reserves the option, in appropriate circumstances, of seeking a penalty that might put a company in severe financial distress. For example, it normally would not be appropriate to reduce a penalty for a company with a long history of previous violations. That long history would demonstrate that less severe measures are ineffective. Similarly, a reduced penalty would not be appropriate if a company's business is viable only if the company is able to continue violating the law. For example, a company found in violation of the defeat device prohibition should not receive a reduced penalty to stay in business if the company intends to continue selling defeat devices.

The financial ability to pay adjustment normally will require a significant amount of financial information specific to the violator. If this information is available prior to commencement of negotiations, it should be assessed as part of the initial penalty target figure. If it is not available pre-negotiation, the litigation team should assess this factor after commencement of negotiations with the violator.

The burden to demonstrate inability to pay, as with the burden of demonstrating the presence of any mitigating circumstances, rests with the violator. If the violator fails to provide sufficient information, then the litigation team should disregard this factor in adjusting the penalty in negotiation.¹³

¹³ Note that under the Environmental Appeals Board (EA.) ruling in *In re: New Waterbury*, 5 E.A.D. 529 (EA. 1994), in administrative enforcement actions for violations under statutes, such as the Clean Air Act, that specify ability to pay as a factor in determining the penalty amount, EPA must prove it adequately considered ability to pay in determining the appropriate penalty. As a result, if a mobile source case is enforced through the formal administrative process, and the defendant is expected to raise its ability to pay as an issue, the litigation team should obtain enough information to demonstrate the defendant's ability to pay was adequately considered when the penalty was calculated. This information can be obtained from the defendant, or from independent sources such as *Dunn and Bradstreet* financial reports on the defendant's business.

When it is determined that a violator cannot afford the penalty prescribed by this Penalty Policy, the following options should be considered:

- Delayed payment schedule: A violator may not have the financial resources necessary to pay the full penalty amount as a one-time payment, but would be able to pay this amount over a period of months or years. However, administration of time-payments is a burden on the Agency, so that this option should be considered only if the Agency is convinced it is not possible for the violator to obtain the funds necessary to pay the full penalty through borrowing money or the sale of assets. If time-payments are used, the violator should pay the largest possible amount of the penalty at the time the case is resolved to reduce the amount of the delayed payments, and the duration of the time-payments should be no longer than is necessary. In any case where time-payments are used, the amount of any delayed payments should be increased to include interest on the delayed payments.
- Straight penalty reductions as a last resort: If this approach is necessary, the reasons for the litigation team's conclusions as to the size of the necessary reduction should be made a part of the case file.

V. Litigation Risk and Other Unique Factors

A case may present other factors that the litigation team believes justify a further increase or reduction of the penalty. For example, a case may have particular strengths or weaknesses that the litigation team believes have not been adequately captured in other areas of this Penalty Policy. For example, if the facts of the case or the nature of the particular regulatory requirement at issue reduce the strength of the Agency's case, this could justify an additional penalty reduction.

Under this Penalty Policy, the litigation team has discretion to increase or decrease the penalty by up to 10 percent to reflect litigation risk or other unique factors. In some cases, such as small-scale imports of small engines, the Preliminary Deterrence Amount generated under this Policy may exceed the value of the goods. In such cases, the litigation team has the discretion to adjust the Preliminary Deterrence Amount accordingly. In other cases, such as those in which the amount of excess emissions is significant, the litigation team has the discretion to increase the penalty to account for the market value of emission offsets. The basis for the level of this adjustment should be described in the case documents. Adjustments greater than 10 percent are possible based upon considerations such as those discussed above, but such larger adjustments must be approved by the Air Enforcement Division Director.

There may be other circumstances in which the facts of a particular case warrants consideration of other factors not specifically identified or discussed in this Penalty Policy, or the adjustment based on listed factors at a percentage or in a manner different than described in this Policy. Such adjustments must also be approved by the Air Enforcement Division Director.

VI. Adjustments to the Initial Penalty Target Figure after Negotiations Have Begun

During the course of settlement negotiations, information often is learned that will cause the litigation team to further reevaluate the facts that led to the particular penalty components and adjustments used to calculate the initial penalty target figure for the case. If so, the penalty should be recalculated to reflect this new information. This new information could affect the following areas:

- Ability to pay (to the extent this was not considered in calculating the initial penalty target figure);
- Adjustments used in calculating the initial penalty target figure; and
- Reassess the preliminary deterrence amount to reflect continued periods of noncompliance not reflected in the original calculation.

The initial penalty target figure, when further adjusted during negotiations based on this new information, yields the adjusted penalty target figure.